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SUBJECT: THE WORD FROM GERMANY'S INDUSTRIAL HEARTLAND: IMPACT OF U.S. ECONOMIC SLOWDOWN ON GERMANY STILL TO COME

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¶1. (SBU) Summary: Senior interlocutors in North-Rhine Westphalia (NRW) told EMIN April 16-17 that the international financial crisis and the weakening U.S. economy have had a limited impact on the real economy. There would, however be "indirect impacts" as growth in Asian and other developing economies, now major export destinations of German goods, also slows. Of greatest concern were the loss of consumer spending as a result of stagnation in real wages and pending EU legislation regulating car emissions. We heard a sense of satisfaction that industry in the Rhine-Ruhr area has thus far ridden out the surging Euro and subprime crisis rather successfully, but also a concern about when the next shoe will drop. End Summary.

¶2. (U) In a series of meetings in Duesseldorf, Bochum, and Cologne on April 16-17, Embassy Economic Minister-Counselor joined Duesseldorf CG and Pol/Econ Officer in discussing issues ranging from the health of the German economy and export sector to the environment and labor costs with senior representatives at the Cologne based Institute of German Economy (IW), one of Germany's five leading national economic think-tanks, the Opel AG automobile assembly plant in Bochum, and the Duesseldorf Chamber of Commerce (IHK). The conversations took place just as the main German economic institutes released their quarterly forecasts, predicting positive growth domestically but a less positive outlook for the U.S. economy.

Germany: Indirectly Affected by U.S. Slowdown

¶3. (SBU) Our interlocutors expressed satisfaction that Germany had weathered the dual storm of the strong euro and weaker demand in the still very important U.S. export market, but remain concerned about the future. IW economists described the close relationship between the German and U.S. economies, but stressed that the U.S. market has become relatively less important over time because of the fast growth of German exports to central and eastern Europe, Russia, China and elsewhere. As German exports to the U.S. currently comprise 7-8 percent of its total, the impact of U.S. developments on the German economy are indirect (i.e. as U.S. demand for Chinese products decreases, so may Chinese demand for German goods). Germany will suffer, they said, but not as badly as in the past because Schroeder-era economic reforms set the stage for a sounder economy, including a more flexible labor market, and exporters have adapted to the global economy. The economists predicted that the slowdown in the U.S. would not have a great impact on German exports to the U.S. because a large percentage of this trade is in premium

products (e.g. luxury cars) for which demand is relatively inelastic. The senior Duesseldorf Chamber of Commerce official largely agreed, but said he feared "adverse affects in the near future" if the worldwide slowdown accelerates.

The Revival of the Old Economy

14. (SBU) The IW economists expressed surprise at the depth and breadth of the German recovery, which in NRW in particular reflected the revival -- and strength -- of its traditional industrial and manufacturing based economy. The reliance on these important sectors, however, left Germany "vulnerable" because a global slowdown would hit its economy more than countries that are less dependent on exports and more service-intensive. This was all the more true because Germany's exports as a proportion of the national economy have doubled to 45 percent since 1990.

Growth Predictions for Germany and the U.S.

15. (SBU) IW economists expect 1.8 percent and 1.4 percent GDP growth for Germany in 2008 and 2009, respectively. They stated that the U.S. is heading for a recession and called the underlying problems "structural" -- reflecting more than just the normal business cycle. In their view, the U.S. recovery will be drawn out over the next few years, with 1 percent GDP growth in 2008 and 1.2 percent in 2009.

Energy & Environment: Consumers will React

16. (SBU) A senior executive at the Opel (GM) assembly plant in Bochum expressed exasperation with German society's fixation on the environment. Opel AG has invested enormous resources in addressing environmental concerns, but hesitated to reveal the added costs of meeting new emissions targets, lest it appear indifferent to climate change. Instead, Opel lobbies hard to sensitize lawmakers and government to the real price of

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environmental regulation but, like other German automobile manufacturers, does so quietly and privately, he stated.

17. (SBU) With regard to emissions standards and their potential cost to consumers, a senior IW economist said the institute believes that Germany will eventually reach the point where environmental policies will be "too financially painful to endure." This is less likely so long as the economy is robustly growing, but should it turn downward, environment-related costs will become an issue, he predicted.

Subprime Crisis

18. (SBU) IW analysts downplayed Germany's problem with the credit crunch growing out of the subprime crisis, pointing to the relative strength of its banks. The IHK worried about lingering uncertainty in the financial sector and its potential impact on its members, mostly "Mittelstand" (SME) companies. The real estate market has remained largely flat over the past 10-15 years, but commercial real estate, we heard from multiple sources, is booming.

Consumer Confidence

19. (SBU) The senior Opel executive lamented declining consumer confidence even among his 4,000-plus employees, which made it more difficult to sell cars. The Schroeder-era had witnessed major wage rollbacks that had hit workers in the pocketbook. Several years ago, for instance, Opel workers agreed to limit pay increases to save the factory, but with inflation, their real buying power had fallen. The union, however, "gets it," which keeps pressure for wage increases down. With 70 percent

of costs being labor (including fringe benefits), the plant has nonetheless laid off some 3,000 employees since 2005 and does not pay overtime on Saturday and Sunday.

¶10. (SBU) Environmental concerns and uncertainty over future emissions regulations had also negatively affected demand for cars, our Opel interlocutor said. The focus on CO2 emissions had prompted many Germans not to buy cars until they see how government emission regulations affect prices. This is having a significant affect on the bottom line, he observed.

Transatlantic Economic Cooperation

¶11. (SBU) The senior IHK official said the Duesseldorf business community has expressed concern about the 100 percent screening requirement for containers entering the United States, observing that it risks becoming an informal trade barrier. Small and medium enterprises consider the time, paperwork, and cost of such efforts to combat terrorism "significant." EMIN responded that it is important to keep in mind that the 100 percent scanning law was quite flexible, and that movement in this direction was inevitable, not just in the U.S. but in Europe as well.

¶12. (SBU) The IHK official did not favor restrictions on sovereign investments funds in Germany. The Chamber has not found evidence that these funds will use their investments for negative purposes, such as to steal technology or dominate certain sectors of the economy. The IHK opposes prohibitions although it believes that Germany should seek more transparency. What is also needed is more public discussion to address underlying fears about these funds. The Duesseldorf region has attracted 200-300 Chinese companies to set up representative offices in recent years. The IHK experience with Indian firms has been largely positive, as many have bought German companies that might otherwise have closed in order to complete their product range.

Comment

¶13. (SBU) These dispassionate assessments contrast with public and media sentiment in NRW, which remains alarmed by the strong euro, the U.S. subprime crisis, and the global slowdown. Germany in their view has thus far withstood these difficulties in large part because of Schroeder-era economic reforms, smaller profit margins, and an increased awareness among labor and management that globalization requires ever greater efforts to remain competitive. No one, on the other hand, was complacent, knowing that financial uncertainty and foreign competition could bring new challenges to Germany's industrial heartland. End Comment.

¶14. (U) This message was coordinated with Embassy Berlin.
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